

**THE JOINT COMMISSION ON ACCREDITATION  
OF HEALTHCARE ORGANIZATIONS AND AFFILIATES**

Consolidated Financial Statements

December 31, 2008 and 2007

(With Independent Auditors' Report Thereon)

**THE JOINT COMMISSION ON ACCREDITATION  
OF HEALTHCARE ORGANIZATIONS AND AFFILIATES**

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**KPMG LLP**  
303 East Wacker Drive  
Chicago, IL 60601-5212

## **Independent Auditors' Report**

The Board of Commissioners  
The Joint Commission on Accreditation of  
Healthcare Organizations:

We have audited the accompanying consolidated statements of financial position of The Joint Commission on Accreditation of Healthcare Organizations and Affiliates (The Joint Commission) as of December 31, 2008 and 2007, and the related consolidated statements of activities, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of The Joint Commission's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of The Joint Commission's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Joint Commission on Accreditation of Healthcare Organizations and Affiliates as of December 31, 2008 and 2007, and the changes in their net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As described in note 7 to the consolidated financial statements, The Joint Commission adopted the provisions of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, as amended, as of January 1, 2008.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The schedule of 2008 consolidating statement of activities information is presented for purposes of additional analysis of the 2008 consolidated financial statements rather than to present the activities of the individual corporations. The consolidating information has been subjected to the auditing procedures applied in the audit of the 2008 consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2008 consolidated financial statements taken as a whole.

**KPMG LLP**

April 21, 2009

**THE JOINT COMMISSION ON ACCREDITATION  
OF HEALTHCARE ORGANIZATIONS AND AFFILIATES**

Consolidated Statements of Financial Position

December 31, 2008 and 2007

<b>Assets</b>	<b>2008</b>	<b>2007</b>
Current assets:		
Cash and cash equivalents	\$ 10,688,628	9,737,460
Short-term investments	3,960,648	3,271,960
Accounts receivable – net of allowance for doubtful accounts of \$545,450 and \$454,000 in 2008 and 2007, respectively	19,552,038	17,204,419
Pledges receivable	525,000	—
Publications inventory – net	1,062,126	967,140
Prepaid expenses	2,175,729	2,068,311
Total current assets	<u>37,964,169</u>	<u>33,249,290</u>
Pledges receivable long term	970,181	—
Investments	79,007,393	104,183,804
Property and equipment:		
Land	4,204,400	4,204,400
Building	27,344,622	27,310,717
Office systems, furniture, and equipment	37,382,210	33,486,197
Total property and equipment	68,931,232	65,001,314
Less accumulated depreciation and amortization	<u>(37,741,795)</u>	<u>(33,352,889)</u>
Total property and equipment – net	31,189,437	31,648,425
Pension assets	—	1,602,178
Unamortized debt issuance costs	420,818	488,189
Total assets	<u>\$ 149,551,998</u>	<u>171,171,886</u>
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Current maturity of note payable	\$ 1,600,000	1,475,000
Accounts payable	7,409,712	6,094,527
Accrued expenses:		
Compensation and benefits	8,719,527	5,343,234
Other expenses	2,005,214	1,059,515
Deferred revenue:		
Accreditation fees and deposits	1,215,788	1,546,095
Publications, educational programs, and other advances	3,910,212	4,471,329
Current portion of accrued postretirement benefit:	2,999,000	2,698,000
Total current liabilities	<u>27,859,453</u>	<u>22,687,700</u>
Noncurrent liabilities:		
Note payable – less current maturity	22,120,000	23,720,000
Accrued pension and postretirement benefits	14,964,675	7,257,149
Fair value of hedge – interest rate swap	2,874,574	1,809,283
Other noncurrent liabilities	445,993	527,231
Total noncurrent liabilities	<u>40,405,242</u>	<u>33,313,663</u>
Total liabilities	68,264,695	56,001,363
Commitments and contingencies	—	—
Net assets:		
Unrestricted net assets	79,041,727	115,170,523
Permanently restricted net assets – endowmen	2,245,576	—
Total net assets	<u>81,287,303</u>	<u>115,170,523</u>
Total liabilities and net assets	<u>\$ 149,551,998</u>	<u>171,171,886</u>

See accompanying notes to consolidated financial statements.

**THE JOINT COMMISSION ON ACCREDITATION  
OF HEALTHCARE ORGANIZATIONS AND AFFILIATES**

Consolidated Statements of Activities

Years ended December 31, 2008 and 2007

	<b>2008</b>	<b>2007</b>
Revenue:		
Annual accreditation subscription fees	\$ 53,384,642	48,888,422
On-site survey fees	58,013,684	48,977,152
Publications and multimedia	18,095,624	18,901,872
Educational programs	8,069,832	6,878,909
Consultative technical assistance	12,694,900	11,061,937
Continuous service readiness	5,208,214	4,659,169
Performance measurement activities	3,118,004	2,921,188
Other	6,372,729	6,704,401
Total revenue	164,957,629	148,993,050
Expenses:		
Salaries and benefits	104,505,515	93,955,484
Travel costs	22,282,078	20,003,172
Publishing and printing	4,541,491	4,477,342
Occupancy	3,918,449	3,618,443
Fees and services	9,920,199	9,795,548
Depreciation and amortization	4,503,822	4,386,240
Other operating expenses	12,269,884	11,837,113
Total expenses	161,941,438	148,073,342
Excess of revenue over expenses before investment income	3,016,191	919,708
Investment income	1,505,545	8,119,446
Excess of revenue over expenses	4,521,736	9,039,154
Other changes in unrestricted net assets:		
Net unrealized investment gains (losses)	(28,221,005)	(3,081,692)
Change in fair value of hedge – interest rate swap	(1,065,291)	(288,079)
Change in unrecognized net defined benefit plan costs not yet recognized in net periodic benefit expense	(11,364,236)	(656,099)
Change in unrestricted net assets	(36,128,796)	5,013,284
Unrestricted net assets – beginning of year	115,170,523	110,157,239
Unrestricted net assets – end of year	\$ 79,041,727	115,170,523

See accompanying notes to consolidated financial statements.

**THE JOINT COMMISSION ON ACCREDITATION  
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Consolidated Statements of Changes in Net Assets

Years ended December 31, 2008 and 2007

	<b>2008</b>	<b>2007</b>
Unrestricted net assets:		
Excess of revenue over expenses	\$ 4,521,736	9,039,154
Other changes in unrestricted net assets:		
Net unrealized investment gains (losses)	(28,221,005)	(3,081,692)
Change in fair value of hedge – interest rate swap	(1,065,291)	(288,079)
Change in unrecognized net defined benefit plan costs not yet recognized in net periodic benefit expense	(11,364,236)	(656,099)
Change in unrestricted net assets	(36,128,796)	5,013,284
Permanently restricted net assets – restricted endowment contributions	2,245,576	—
Change in net assets	(33,883,220)	5,013,284
Net assets – beginning of year	115,170,523	110,157,239
Net assets – end of year	\$ 81,287,303	115,170,523

See accompanying notes to consolidated financial statements.

**THE JOINT COMMISSION ON ACCREDITATION  
OF HEALTHCARE ORGANIZATIONS AND AFFILIATES**

Consolidated Statements of Cash Flows

Years ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Change in net assets	\$ (33,883,220)	5,013,284
Adjustment to reconcile change in net assets to net cash provided by operating activities:		
Realized investment (gains) losses, net	1,137,979	(5,121,246)
Unrealized investment losses, net	28,221,005	3,081,692
Change in fair value of hedge – interest rate swap	1,065,291	288,079
Change in unrecognized net defined benefit plan costs not yet recognized in net periodic benefit expense	11,364,236	656,099
Permanently restricted endowment contributions	(2,245,576)	—
Depreciation and amortization	4,503,822	4,386,240
Changes in assets and liabilities:		
Accounts receivable	(2,347,619)	(251,888)
Pledges receivable	(1,495,181)	—
Accounts payable and accrued expenses	5,637,177	(576,732)
Deferred revenue	(891,424)	784,217
Accrued pension and postretirement benefits	(1,753,533)	(1,019,643)
Other assets and liabilities	(283,641)	(439,535)
Net cash provided by operating activities	<u>9,029,316</u>	<u>6,800,567</u>
Cash flows from investing activities:		
Purchases of investments	(13,002,311)	(10,948,675)
Sales and maturities of investments	8,131,050	8,668,431
Additions to property and equipment	(3,977,463)	(3,533,995)
Net cash used in investing activities	<u>(8,848,724)</u>	<u>(5,814,239)</u>
Cash flows from financing activities:		
Permanently restricted endowment contributions	2,245,576	—
Principal payments of note payable	(1,475,000)	(1,360,000)
Net cash from financing activities	<u>770,576</u>	<u>(1,360,000)</u>
Net increase (decrease) in cash and cash equivalents	951,168	(373,672)
Cash and cash equivalents – beginning of year	<u>9,737,460</u>	<u>10,111,132</u>
Cash and cash equivalents – end of year	<u>\$ 10,688,628</u>	<u>9,737,460</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	\$ 945,819	1,016,936

See accompanying notes to consolidated financial statements.

**THE JOINT COMMISSION ON ACCREDITATION  
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Notes to Consolidated Financial Statements

December 31, 2008 and 2007

**(1) Nature of Organization and Summary of Significant Accounting Policies**

**(a) *Nature of the Organization***

The Joint Commission on Accreditation of Healthcare Organizations (The Joint Commission) is a not-for-profit organization that seeks to continuously improve the safety and quality of care provided to the public through the provision of healthcare accreditation and related services that support performance improvement in healthcare organizations. Together, annual accreditation subscription fees and on-site survey fees account for the largest portion of The Joint Commission's total revenue.

**(b) *Principles of Consolidation***

The accompanying consolidated financial statements include the accounts of The Joint Commission and its wholly controlled affiliates, Joint Commission Resources, Inc. (JCR) and The Joint Commission Center for Transforming Healthcare (The Center). JCR is a not-for-profit organization that was established for the purpose of independently assisting healthcare organizations in improving the quality of their services. JCR accomplishes this objective through the provision of publications and periodicals, educational programs, consultative technical assistance, contracted evaluation services, subscription readiness services, and international accreditation. The Center for Transforming Healthcare is also a not-for-profit organization. The Center was established for the purpose of applying robust process improvement methods to transform healthcare into a high-reliability industry. An additional controlled not-for-profit affiliate, JCAHO Surveyor and QHR Consultant Corporation, administers an employment program for The Joint Commission and is also included in the accompanying consolidated financial statements. All intercompany transactions and balances have been eliminated in the accompanying consolidated financial statements.

**(c) *Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities; disclosure of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates.

**(d) *Cash and Cash Equivalents***

For purposes of reporting, all cash and investments with a maturity at the date of purchase of three months or less are considered cash and cash equivalents.

**(e) *Pledges Receivable***

The Joint Commission reports unconditional promises to give as contributions. If pledges are expected to be collected in less than one year, they are recorded at the estimated amount to be ultimately realized. If pledges are to be paid to the organization over a period of years, they are recorded at the present value of their estimated cash flows using the prime rate as of the fiscal year-end in the year of donation.

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**(f) Investments**

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based primarily on quoted market prices or observable market inputs in the accompanying consolidated statements of financial position. Investments in common and collective trust funds that invest in publicly traded securities are carried at fair value as determined by the fund manager based on The Joint Commission's proportionate interest in the fund at December 31. Interest and dividend income and realized gains and losses on sales of investments are reported as investment income or loss, while unrealized gains (losses) are reported separately in the accompanying consolidated statements of activities as a component of other changes in unrestricted net assets. Short-term investments have maturities of less than one year. Long-term investments have maturities of more than one year.

**(g) Publications Inventory**

Publications offered for sale or used in educational programs are stated at the lower of cost (first-in, first-out) or market, net of an allowance for excess and obsolete inventory, in the amounts of approximately \$696,000 and \$525,000 at December 31, 2008 and 2007, respectively.

**(h) Property and Equipment**

Property and equipment are stated at cost and are depreciated over their estimated useful lives using the straight-line method, as follows:

Building	40 years
Office systems, furniture, and equipment	3 – 15 years
Leasehold improvements	life of lease

Betterments, improvements, and repairs that extend the useful life of an asset and exceed \$1,000 are capitalized. Routine repairs and maintenance are expensed as incurred.

The Joint Commission accounts for long-lived assets in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This statement requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. The Joint Commission did not recognize any impairment charges in 2008 or 2007.

**(i) System Development Costs**

The Joint Commission capitalizes certain costs of business systems developed or obtained for internal use, consistent with the provisions of Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Such system development costs, which

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include external direct costs of materials and services and payroll costs for employees directly associated with system development projects, are amortized over a three- or five-year period using the straight-line method.

**(j) Debt Issuance Costs**

Financing and other costs incurred in connection with the issuance of long-term debt are amortized over the life of the debt using the effective interest method.

**(k) Contributions**

The Joint Commission maintains its accounts in accordance with the principles and practices of fund accounting. Fund accounting is the procedure by which resources for various purposes are classified for accounting purposes in accordance with activities or objectives specified by donors.

These financial statements have been prepared to focus on The Joint Commission as a whole and to present balances and transactions classified according to the existence or absence of donor-imposed restrictions. This has been accomplished by classification of fund balances into three classes of net assets – permanently restricted, temporarily restricted, or unrestricted.

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or are restricted by the donor for specific purposes are reported as temporarily restricted. Amounts required to be maintained in perpetuity by the donor are reported as permanently restricted net assets.

Contributions, including unconditional pledges, are recognized in the period received. Conditional pledges are not recognized until the conditions on which they depend are substantially met. A donor restriction expires when a time restriction ends or when the purpose for which it was intended is attained. Upon expiration, temporarily restricted net assets are reclassified to unrestricted net assets and are reported in the statements of activities as net assets released from restrictions.

**(l) Derivative Instruments and Hedging Activities**

Effective January 1, 2001, The Joint Commission adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. The derivative financial instrument used by The Joint Commission is an interest rate swap, in which a counterparty agrees to make variable payments based on a market interest rate (index rate). The fair value of the swap is included in noncurrent liabilities in the accompanying consolidated statements of financial position. The Joint Commission entered into the interest rate swap to hedge its exposure to fluctuations of the variable rate interest payments that relate to The Joint Commission's outstanding variable rate debt. Management reports the change in the fair value of the swap as a change in unrestricted net assets in the accompanying consolidated statements of activities.

**(m) Revenue**

Organizations agree to pay an annual subscription fee for their participation in the ongoing services provided by The Joint Commission. In addition, organizations agree to pay an add-on fee in those

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years in which on-site surveys are conducted. Revenue from annual accreditation subscription fees is recognized ratably over the period to which the subscription fees relate. On-site survey fees are recognized in the period when the on-site surveys are conducted.

Revenue from consultative technical assistance, educational programs, and continuous service readiness is recognized when the related services are provided. Revenue from the sale of publications and multimedia is recognized when the related goods have been delivered and risk of loss has passed to the customer, persuasive evidence of an arrangement exists, the sales price is determinable, and collection of the related receivable is reasonably assured. Advance collections and deposits are recorded as deferred revenue in the accompanying consolidated statements of financial position.

During 2007, JCR accelerated the release of its Accreditation Manager Plus (AMP) product. The AMP product is offered to JCR subscribers on an annual basis. Historically, the AMP product has been released in the first quarter of JCR's fiscal year with revenue for the product recognized within the same fiscal year. The accelerated release of the AMP product in the fourth quarter 2007 resulted in additional revenue of \$1.8 million.

**(n) *Income Taxes***

The Internal Revenue Service has determined that The Joint Commission and its affiliates are exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code. The Joint Commission and its affiliates are subject to income taxes only on income determined to be unrelated business taxable income. During the year ended December 31, 2007, The Joint Commission adopted the Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*. There was no impact on the consolidated financial statements as a result of the implementation.

**(o) *Foreign Currency***

Transaction gains and losses resulting from settlement in foreign currency are recorded in the period in which the transaction occurs and are recorded as other revenue in the accompanying consolidated statements of activities. During 2008 and 2007, losses totaling \$202,648 and gains totaling \$134,748, respectively, were recognized.

**(p) *New Accounting Pronouncements***

SFAS No. 157, *Fair Value Measurements* (SFAS 157), as amended, was effective for The Joint Commission on January 1, 2008 (note 7). SFAS 157 defines fair value, establishes a framework for measuring fair value in U.S. generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 amends and expands the disclosure requirements for derivative instruments and hedging activities by requiring enhanced disclosures about how and why the organization uses derivative instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments

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and related hedged items affect The Joint Commission's financial position, financial performance, and cash flows. SFAS 161 is effective for The Joint Commission in fiscal year 2009.

**(q) *Reclassifications***

Certain reclassifications have been made to the 2007 consolidated financial statements to conform to the 2008 presentation.

**(2) Note Payable and Interest Rate Swap**

In October 1988, The Joint Commission entered into a Financing Agreement (the Agreement) with the City of Elmhurst, Illinois (the City) to finance the acquisition of land and the construction and furnishing of a new office building, as well as costs The Joint Commission might incur in exiting existing long-term lease agreements and in moving its operations to the new facility. Pursuant to the Agreement, the City issued \$37,000,000 of its tax-exempt Adjustable Demand Revenue Bonds and used the proceeds to purchase The Joint Commission's Adjustable Demand Note (the Note). The Joint Commission has occupied the office building since April 1990.

Under the terms of the Note, The Joint Commission is required to pay principal and interest in amounts sufficient to cover principal and interest on the bonds issued by the City. As security for the Note and to ensure the City's ability to meet the terms of its related bonds, The Joint Commission provided the City a direct pay letter of credit of \$24,180,103. In so doing, The Joint Commission agreed to pay the bank issuance fees as well as an annual fee on the unused portion of the letter of credit, which is currently 0.019%. The letter of credit expires in early 2013.

The Joint Commission and JCR are jointly and severally liable for amounts due to the issuing letter of credit bank. As security for the letter of credit, The Joint Commission has granted the issuing bank a first mortgage and security interest in virtually all of The Joint Commission's assets. Further, under the terms of the letter-of-credit agreement, The Joint Commission and JCR have agreed to meet various covenants on a consolidated basis, including maintenance of certain financial ratios and a minimum level of cash and investments.

The Note matures on July 1, 2018. Note redemption commenced on July 1, 1994, and will continue pursuant to the terms of the Agreement through maturity. Holders of the bonds have the right to put the bonds prior to maturity. The Joint Commission has an agreement with an underwriter to remarket any put bonds. In the event the agent is unable to remarket the bonds, the bonds become a demand note under the letter of credit. The Note is also subject to mandatory redemption upon expiration of the letter of credit unless a suitable alternative letter of credit is in place.

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The annual maturities of the Note are as follows:

2009	\$	1,600,000
2010		1,735,000
2011		1,885,000
2012		2,040,000
2013		2,215,000
Thereafter		<u>14,245,000</u>
Total	\$	<u><u>23,720,000</u></u>

Interest on the Note is variable and subject to weekly adjustments that parallel fluctuations in the municipal bond market. The effective interest rate on the Note was 2.12% in 2008 and 3.64% in 2007. The interest rate for nonpayment of principal or interest is the prime rate plus 2.00%. Under certain conditions described in the Agreement, The Joint Commission may convert its interest rate on the Note to a fixed interest rate or a floating rate that changes less frequently than weekly.

The Joint Commission utilizes an interest rate swap agreement to reduce the risk associated with the weekly adjustment to the Note's interest rate. The interest rate swap agreement involves a declining notional amount that reflects two-thirds of the remaining principal balance of the Note. The following table summarizes the swap agreement terms in place and fair value during 2008 and 2007:

Notional amount (in millions)	Expiration	Fixed rate	December 31,	
			2008	2007
\$17.7 to \$15.8	2018	4.88%	\$ (2,874,574)	(1,809,283)

The Joint Commission makes monthly payments to a counterparty at a fixed rate of 4.88%, and in return, receives monthly payments based on 67% of a LIBOR index. Management continually monitors the credit rating of the counterparty, which is a large financial institution. Should nonperformance of the counterparty occur, interest costs would fluctuate with the weekly adjustable interest rate under the Note. The fair value of the swap is presented as a noncurrent liability in the accompanying consolidated statements of financial position.

Interest expense totaled \$936,232 in 2008 and \$1,098,770 in 2007, inclusive of interest rate swap monthly settlement payments of \$417,947 and \$148,480 in 2008 and 2007, respectively. Interest expense is included in occupancy expense in the accompanying consolidated statements of activities.

The estimated fair value of debt obligations, as determined by The Joint Commission's bond remarketing agent, approximates the carrying value at December 31, 2008 and 2007.

**(3) Leases**

The Joint Commission primarily leases office space, laptop computers, printers, and copiers under operating lease arrangements. Lease terms generally range from three to six years and contain renewal or

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purchase options. The Joint Commission also leases office space in Washington, DC. During 2004, in connection with the relocation of its headquarters, JCR entered into a ten and one-half year operating lease for office space that includes a renewal option and scheduled rent increases. In late 2007, the agreement was expanded to include additional office space and extended the current lease through early 2019. Rent expense is recognized over the life of the lease using the straight-line method. There are no leases that contain restrictions on The Joint Commission's ability to incur additional debt or engage in further leasing activities. JCR also leases office space in Italy, France, Dubai, and Singapore. Obligations in foreign currency are reflected in U.S. dollars as of December 31, 2008. Such obligations are subject to foreign currency exchange risk.

Rent expense related to operating lease agreements was \$2,050,947 in 2008 and \$1,823,138 in 2007.

Obligations under operating leases having initial terms in excess of one year at current rates are as follows:

2009	\$	1,455,595
2010		1,152,923
2011		1,145,621
2012		880,351
2013		747,716
Thereafter		<u>1,356,397</u>
Total	\$	<u><u>6,738,603</u></u>

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Notes to Consolidated Financial Statements

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**(4) Investments**

The following table summarizes the types of investments and total return on investments as of and for the years ended December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Type of investments:		
U.S. government and government agency securities	\$ 2,283,872	3,848,372
Common and collective trust funds	37,629,917	41,943,478
Corporate bonds and bond funds	339,207	512,668
Common stock and stock funds	42,715,045	61,151,246
Total investments – at fair value	<u>\$ 82,968,041</u>	<u>107,455,764</u>
Return on investments:		
Interest income and dividends	\$ 2,643,524	2,998,200
Realized gains (losses) on sales of investments, net	(1,137,979)	5,121,246
Unrealized market depreciation, net	(28,221,005)	(3,081,692)
Total return on investments	<u>\$ (26,715,460)</u>	<u>5,037,754</u>
Reported as:		
Investment income	\$ 1,505,545	8,119,446
Net unrealized investment losses	(28,221,005)	(3,081,692)
Total return on investments	<u>\$ (26,715,460)</u>	<u>5,037,754</u>

**(5) Retirement Plans and Other Post Retirement Benefits**

The Joint Commission has a noncontributory account-based defined benefit pension plan (the Pension Plan) that covers substantially all of its employees. The Joint Commission’s funding policy is to contribute to the Pension Plan an annual amount necessary to meet or exceed the minimum funding standards under the Employee Retirement Income Security Act.

The Joint Commission also sponsors nonqualified supplemental defined benefit retirement plans for certain key executives (the Supplemental Plans). Benefit cost under the Supplemental Plans is accrued based on actuarial estimates over the expected service period of key executives. The Supplemental Plans are not funded; however, marketable securities totaling \$4,439,349 and \$7,172,900 at December 31, 2008 and 2007, respectively, were designated for the payment of benefits under the Supplemental Plans when due. Management expects to contribute amounts sufficient to pay benefits when due under the Supplemental Plans. The Joint Commission also provides certain executives with defined benefit postretirement healthcare benefits on an unfunded basis. The amounts included in “Other benefits” in the following tables include the Supplemental Plans and the defined benefit postretirement healthcare benefits.

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The following tables set forth information on the funded status, amounts recognized in the accompanying consolidated financial statements, and weighted average assumptions related to The Joint Commission's Pension Plan and other postretirement defined benefit plans for the years ended December 31, 2008 and 2007:

	<b>Pension Plan</b>		<b>Other benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Change in projected benefit obligation:				
Projected benefit obligation at beginning of year	\$ 30,484,319	29,307,012	9,955,149	9,259,044
Service cost	2,383,690	2,282,435	933,138	1,043,368
Interest cost	1,936,799	1,649,292	466,067	454,911
Actuarial (gain) loss	1,815,291	(663,107)	83,830	1,354,342
Benefits paid	(1,705,091)	(2,091,313)	(2,724,735)	(2,156,516)
Projected benefit obligation at end of year	<u>\$ 34,915,008</u>	<u>30,484,319</u>	<u>8,713,449</u>	<u>9,955,149</u>
Change in fair value of plan assets:				
Fair value of plan assets at beginning of year	\$ 32,086,497	29,849,540		
Actual gain (loss) on plan assets	(7,416,624)	2,128,270		
Employer contributions	2,700,000	2,200,000		
Benefits paid	(1,705,091)	(2,091,313)		
Fair value of plan assets at end of year	<u>\$ 25,664,782</u>	<u>32,086,497</u>		
Funded status	<u>\$ (9,250,226)</u>	<u>1,602,178</u>	<u>(8,713,449)</u>	<u>(9,955,149)</u>
Amounts recognized in the consolidated statements of financial position consist of:				
Noncurrent assets (liabilities)	\$ (9,250,226)	1,602,178	—	—
Current liabilities	—	—	(2,999,000)	(2,698,000)
Noncurrent liabilities	—	—	(5,714,449)	(7,257,149)
Accumulated charge to unrestricted net assets	<u>16,818,689</u>	<u>5,307,706</u>	<u>1,069,377</u>	<u>1,216,124</u>
	<u>\$ 7,568,463</u>	<u>6,909,884</u>	<u>(7,644,072)</u>	<u>(8,739,025)</u>

The accumulated charge to unrestricted net assets as of December 31, 2008 and 2007 represents charges or credits arising from the defined benefit plans, but not yet recognized as components of net periodic benefit expense. The accumulated charge to unrestricted net assets at December 31, 2008 of \$17,888,066 is comprised of \$18,028,200 of unrecognized net actuarial losses and \$140,134 of unrecognized prior service credits. During 2009, approximately \$1,259,000 is expected to be reclassified from the accumulated charge to unrestricted net assets for defined benefit plans to pension benefit expense.

The accumulated charge to unrestricted net assets at December 31, 2007 of \$6,523,830 is comprised of \$6,698,996 of unrecognized net actuarial losses and \$175,166 of unrecognized prior service credits. During

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2008, approximately \$373,000 was reclassified from the accumulated charge to unrestricted net assets for defined benefit plans to pension benefit expense.

The accumulated benefit obligation for the Pension Plan was \$32,180,887 and \$28,884,043 at December 31, 2008 and 2007, respectively.

Net periodic benefit cost, which is calculated using the projected unit credit method, for the years ended December 31, 2008 and 2007 included the following components:

	<u>Pension plan</u>		<u>Other benefits</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Components of net periodic benefit cost:				
Service cost	\$ 2,383,690	2,282,435	933,138	1,043,368
Interest cost	1,936,799	1,649,292	466,067	454,911
Expected return on plan assets	(2,576,920)	(2,368,491)	—	—
Net amortization of actuarial losses and prior service cost	297,852	299,697	75,040	45,324
Settlement	—	—	155,537	(69,664)
Net periodic benefit cost	<u>\$ 2,041,421</u>	<u>1,862,933</u>	<u>1,629,782</u>	<u>1,473,939</u>
Weighted average assumptions:				
Discount rate used to determine obligations at year-end	6.25%	6.25%	6.25%	6.25%
Discount rate used to determine net periodic benefit cost	6.25	5.75	6.25	5.75
Rate of compensation increase	4.75	4.75	4.75	4.75
Expected return on plan assets	8.00	8.00	—	—

The assumed healthcare trend rates for the postretirement medical benefits were: 7% grading to 5% for 2008 and 8% grading to 5% for 2007. Actuarial gains and losses, calculated as the difference between estimates and actual amounts of plan assets and the projected benefit obligation, are amortized over the expected future service period. Prior service cost is amortized over the expected future service period.

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The Pension Plan's assets are invested according to target allocations, as outlined in the table below. Management seeks to maximize return with a minimal amount of risk by diversifying the risks of the portfolio over different industries and sectors. Management reviews this investment policy on an ongoing basis.

<u>Asset category</u>	<u>Target allocation</u>	<u>December 31</u>	
		<u>2008</u>	<u>2007</u>
Equity securities	40% – 70%	51%	64%
Debt securities	35 – 55	44	31
Real estate	0 – 7	5	5
Total		<u>100%</u>	<u>100%</u>

The expected return on plan assets, using a rate assumption of 8%, is based upon the average income that management anticipates a portfolio allocated according to The Joint Commission's target asset allocation will earn. Management monitors this assumption on an ongoing basis.

For the year ended December 31, 2009, there is no minimum funding requirement for the Pension Plan; however, management expects to contribute \$4,500,000 to the Pension Plan. Estimated future benefit payments from the Pension Plan are as follows:

2009	\$ 2,800,000
2010	2,600,000
2011	2,600,000
2012	2,900,000
2013	2,800,000
2014 through 2015	<u>15,400,000</u>
Total	<u>\$ 29,100,000</u>

The Joint Commission expects to designate an additional \$2,986,000 in marketable securities during 2009 for the Supplemental Plans. Estimated annual future benefit payments from the Supplemental Plans are anticipated to range from \$28,000 to \$2,999,000 during the period from 2009 through 2013 and are expected to total \$3,922,000 during the period from 2014 through 2018. The benefit payments during 2009 are expected to total \$2,999,000 and are classified as short-term on the accompanying consolidated statements of financial position.

The Joint Commission also sponsors a 401(k) Smart Saver Plan whereby employees may contribute a portion of current earnings, up to certain limits established by the Internal Revenue Service, to the plan and The Joint Commission makes a matching contribution equal to 50% of the first 6% of annual salary contributed by the employee. The Joint Commission's expense under this plan was limited to its contributions, which was \$1,679,441 in 2008 and \$1,577,602 in 2007. The Joint Commission funds this plan on a current basis.

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**(6) Permanent Endowment Funds**

Endowment fund agreements are between The Joint Commission Center for Transforming Healthcare and various donors. The Center and its endowment funds are managed by The Joint Commission. As required by U.S. generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the board of directors to function as endowment funds, are classified and reported based on the existence of donor-imposed restrictions. In the investment and handling of funds, The Joint Commission is subject to the law of Illinois, *The Uniform Management of Institutional Funds Act* “UMIFA” (760 ILCS 60/1 *et seq.*) The board of directors of The Joint Commission has interpreted UMIFA as requiring preservation of the fair value of the original gift as of the gift date of donor-restricted endowment contributions absent explicit donor stipulations to the contrary. As a result of this interpretation, The Joint Commission classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment, the original value of subsequent gifts to the permanent endowment, and accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UMIFA. In accordance with UMIFA, the organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the organization and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the organization
- (7) The investment policies of the organization.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that UMIFA requires The Center to retain as a fund of perpetual duration. These deficiencies result from unfavorable market fluctuations that occur after the investment of permanently restricted contributions. Any deficiencies of this nature are reported in unrestricted net assets. There were no such deficiencies as of December 31, 2008.

The Center has adopted an investment policy for endowment assets that attempts to provide a reasonably predictable stream of funding to support its activities while seeking to preserve capital. Endowment assets include those assets of donor-restricted funds that The Center must hold in perpetuity and for a term-specified period. The Center’s policy requires assets to be invested in a manner that strives to produce results that exceed the Lehman Brothers 1 – 3 Government/Credit index over three- to five-year periods. The Center expects that its endowment assets, under the current strategy, will produce an average rate of return of 3% – 4% annually. Actual returns in any given year may vary from this amount.

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To satisfy its current rate of return objective, The Center relies on a strategy in which investment returns are achieved primarily through interest income. As The Center's endowment funds grow, this strategy may be revised to accommodate capital appreciation through investment in equity securities. However, the size of the current endowment assets prohibits The Center from adopting an effective diversification strategy at this time.

The Center has established the objective of using investment income on endowment assets to fund The Center's activities. However, the level of assets as of December 31, 2008 coupled with the current return objectives are insufficient to generate the level of income needed to fully fund the planned activities. As a consequence, The Center will need to obtain funds from The Joint Commission until endowment assets reach a level that will permit greater emphasis on equity-based investments with prudent risk constraints.

In fiscal year 2008, The Center received donor-restricted endowment pledges totaling \$2,325,395. The Center received the first installment on these pledges in the amount of \$750,395 in December 2008. The remaining installments are expected in 2009, 2010, and 2011. Pledge amounts due in excess of one year after December 31, 2008 have been discounted to net realizable value at a discount rate of 3.25%.

Permanently restricted pledge installments are scheduled to be received as follows:

2009	\$	525,000
2010		525,000
2011		<u>525,000</u>
Total	\$	<u><u>1,575,000</u></u>

The Joint Commission has committed to provide equity capital of \$10,000,000 to The Center; \$8,900,000 of which is payable in 2009 with the remaining \$1,100,000 payable in 2010.

**(7) Fair Value of Financial Instruments**

Effective January 1, 2008, The Joint Commission adopted SFAS 157, as amended, which requires use of a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels: quoted market prices in active markets for identical assets or liabilities (Level 1); inputs other than quoted market prices that are observable for the asset or liability, either directly or indirectly (Level 2); and unobservable inputs for an asset or liability (Level 3).

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The Joint Commission's financial instruments, including cash, accounts receivable, accounts payable, accrued expenses, and deferred revenues, are carried at historical cost, which approximates their fair values because of the short-term nature of these instruments. The carrying value of notes payable approximates fair value based on the variable interest rate for the note. The Joint Commission's cash equivalents, investments and interest rate swap liability are accounted for at fair value using the fair value hierarchy of SFAS No. 157 as follows:

	<b>December 31, 2008</b>		
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Cash equivalents	\$ —	6,475,743	—
Type of investments:			
U.S. government and government agency securities	1,136,258	1,147,614	—
Common and collective trust funds	—	37,629,917	—
Corporate bonds and bond funds	—	339,207	—
Common stock and stock funds	38,759,080	3,955,965	—
Total investments – at fair value	\$ 39,895,338	43,072,703	—
Interest rate swap liability	\$ —	2,874,574	—

**(8) Functional Expenses**

The Joint Commission provides services and products which promote patient safety and quality in the delivery of healthcare services. Expenses related to providing these services and products approximated 76% of total expenses in 2008 and 2007. Expenses incurred were for:

	<b>Program services</b>		<b>Management and general</b>		<b>Total</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Salaries and benefits	\$ 83,992,546	75,824,514	20,512,969	18,130,970	104,505,515	93,955,484
Travel costs	21,042,750	18,599,604	1,239,328	1,403,568	22,282,078	20,003,172
Publishing and printing	4,274,223	4,176,419	267,268	300,923	4,541,491	4,477,342
Occupancy	1,793,461	1,808,013	2,124,988	1,810,430	3,918,449	3,618,443
Fees and services	3,735,188	3,891,807	6,185,011	5,903,741	9,920,199	9,795,548
Depreciation and amortization	2,036,330	2,047,381	2,467,492	2,338,859	4,503,822	4,386,240
Other operating expenses	6,911,895	6,843,691	5,357,989	4,993,422	12,269,884	11,837,113
Total expenses	\$ 123,786,393	113,191,429	38,155,045	34,881,913	161,941,438	148,073,342

**(9) Commitments and Contingencies**

The Joint Commission is subject to legal proceedings and regulatory investigations arising in the course of its normal business activities. In the opinion of management, any such matters will be resolved without material adverse effect on The Joint Commission's financial position or results of operations.

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Schedule

Consolidating Schedule of Statement of Activities Information – Unrestricted Funds

Year ended December 31, 2008

	<b>The Joint Commission</b>	<b>Joint Commission Resources, Inc.</b>	<b>The Joint Commission Center for Transforming Healthcare</b>	<b>Intercompany Eliminations</b>	<b>Consolidated</b>
Revenue:					
Annual accreditation subscription fees	\$ 53,384,642	—	—	—	53,384,642
On-site survey fees	53,901,655	4,112,029	—	—	58,013,684
Publications and multimedia	—	18,095,624	—	—	18,095,624
Educational programs	—	8,069,832	—	—	8,069,832
Consultative technical assistance	—	12,694,900	—	—	12,694,900
Continuous service readiness	—	5,208,214	—	—	5,208,214
Performance measurement activities:	3,118,004	—	—	—	3,118,004
Other	8,058,705	3,121,132	—	(4,807,108)	6,372,729
<b>Total revenue</b>	<b>118,463,006</b>	<b>51,301,731</b>	<b>—</b>	<b>(4,807,108)</b>	<b>164,957,629</b>
Expenses:					
Salaries and benefits	79,824,159	24,681,356	—	—	104,505,515
Travel costs	18,759,685	3,519,274	3,119	—	22,282,078
Publishing and printing	1,723,720	2,817,771	—	—	4,541,491
Occupancy	3,103,877	814,572	—	—	3,918,449
Fees and services	3,258,586	11,311,390	157,331	(4,807,108)	9,920,199
Depreciation and amortization	3,968,160	533,887	1,775	—	4,503,822
Other operating expenses	6,718,749	5,550,010	1,125	—	12,269,884
<b>Total expenses</b>	<b>117,356,936</b>	<b>49,228,260</b>	<b>163,350</b>	<b>(4,807,108)</b>	<b>161,941,438</b>
Excess of revenue over expenses before investment income	1,106,070	2,073,471	(163,350)	—	3,016,191
Investment income	1,275,192	230,353	—	—	1,505,545
<b>Excess of revenue over expenses</b>	<b>2,381,262</b>	<b>2,303,824</b>	<b>(163,350)</b>	<b>—</b>	<b>4,521,736</b>
Other changes in unrestricted net assets:					
Net unrealized investment gains (losses)	(24,082,721)	(4,138,284)	—	—	(28,221,005)
Change in fair value of hedge – interest rate swap	(1,065,291)	—	—	—	(1,065,291)
Change in unrecognized net defined benefit plan costs not yet recognized in net periodic benefit cost	(11,423,310)	59,074	—	—	(11,364,236)
<b>Change in unrestricted net assets</b>	<b>(34,190,060)</b>	<b>(1,775,386)</b>	<b>(163,350)</b>	<b>—</b>	<b>(36,128,796)</b>
Unrestricted net assets – beginning of year	94,807,132	20,363,391	—	—	115,170,523
Unrestricted net assets – end of year	\$ 60,617,072	18,588,005	(163,350)	—	79,041,727

See accompanying independent auditors' report.